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FIA

By Commission Website

August 27, 2012

Mr. David A. Stawick
Secretary
Commodity Futures Trading Commission
1155 21st Street NW
Washington DC 20581

Re: RIN 3038-AD57: Proposed Interpretive Guidance on the Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act 77 Fed.Reg. 41214 (July 12, 2012)

Dear Mr. Stawick:

The Futures Industry Association ("FIA")[1] is pleased to submit this letter in response to the Commodity Futures Trading Commission's ("Commission's") request for comment on the Commission's proposed interpretive guidance on the cross-border application of certain swaps provisions of the Commodity Exchange Act ("Act") (the "Proposed Guidance"), which describes the "general manner in which the Commission will consider whether a person's swap dealing activities or swap positions may require registration as a swap dealer . . . and the application of the related requirements under the CEA to swaps involving such persons; and the application and Policy Statement on Cross-Border Application of Certain Provisions of the of the clearing, trade execution and certain recordkeeping and reporting provisions under the CEA, to certain cross-border swaps involving one or more counterparties that are not swap dealers."[2]

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[1] FIA is the leading trade organization for the futures, options and over-the-counter ("OTC") cleared derivatives markets. It is the only association representative of all organizations that have an interest in the listed derivatives markets. Its membership includes the world's largest derivatives clearing firms as well as leading derivatives exchanges from more than 20 countries. As the principal members of the derivatives clearing organizations, our member firms play a critical role in the reduction of systemic risk in the financial markets. They provide the majority of the funds that support these clearinghouses and commit a substantial amount of their own capital to guarantee customer transactions.

FIA's core constituency consists of futures commission merchants ("FCMs"), and the primary focus of the association is the global use of exchanges, trading systems and clearinghouses for derivatives transactions. FIA's regular members, which act as the majority clearing members of the U.S. exchanges, handle more than 90 percent of the customer funds held for trading on US futures exchanges.

[2] 77 Fed.Reg. 41214 (July 12, 2012).

FIA representatives actively participated in the preparation of the comment letter that the Securities Industry and Financial Markets Association ("SIFMA") has filed with the Commission ("SIFMA Letter").[3] We strongly support the views expressed therein and commend them to the Commission for its consideration. Our letter will focus on two issues of particular importance to FIA: (i) the scope of the US person definition; and (ii) substituted compliance.

Scope of the US Person Definition

In its excellent discussion of the Commission's proposed definition of a "US person", the SIFMA Letter notes that, despite its intended limited purpose,[4] the definition may become the *de facto* definition of a "US person" for all purposes of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"). Although the letter supports the application of this definition for purposes of the regulation of swap dealers under Title VII, the letter also emphasizes that the definition of a US person should not extend to those provisions of the Act governing the activities of FCMs with respect to both (i) exchange-traded futures, whether executed on a designated contract market or a foreign board of trade, and (ii) cleared swaps.[5] Rather, consistent with existing market practice, only those persons located in the United States should be required to maintain accounts with a US FCM.

FIA strongly endorses SIFMA's recommendation. As the letter notes, "this approach is operationally and logistically sound and facilitates portfolio margining to the extent available."[6]

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[3] Letter from Kenneth E. Bentsen, Jr., Executive Vice President, Public Policy and Advocacy, to David A. Stawick, Secretary of the Commission, dated August 27, 2012.

[4] In the Federal Register release accompanying the Proposed Guidance, the Commission states that the definition is "for the purposes of [the] interpretive guidance." 77 Fed.Reg. 41214, 41218 (July 12, 2012)

[5] The Commission's proposed definition includes a number of entities that FCMs generally have not considered to be US persons for purposes of trading both US and non-US futures contracts, including, for example, (i) legal entities organized under the laws of a jurisdiction located outside of the US in which the direct or indirect owners thereof are responsible for the liabilities of such entity and one or more of such owners is a US person, and (ii) commodity pools, pooled accounts, and collective investment vehicles organized under the laws of a jurisdiction located outside of the US, the operator of which would be required to register as a commodity pool operator under the Act.

Such entities frequently open futures trading accounts with non-US brokers, including affiliates of US FCMs. To the extent these entities open accounts with US FCMs, they are permitted to trade foreign stock index contracts that the Commission has not approved for trading by US persons. *See*, Commission Order: Offer and Sale of Foreign Exchange-Traded Options, and Foreign Exchange-Traded Futures Contracts Based on Foreign Stock Indexes and Foreign Government Debt, to Persons Located Outside the United States, 57 Fed.Reg. 36369. August 13, 1992.

[6] SIFMA Letter, p. A-14.

We want to stress that the above policy goes beyond "market practice" and reflects long-established Commission policy. Historically, the Commission has taken the position that an intermediary is required to be registered with the Commission in an appropriate capacity if either the intermediary is located in the US or the intermediary's customer (or potential customer) is located in the US. This position appears to have been adopted first in 1976 in a Commission staff letter, in which the Office of the General Counsel stated that a pool operator would not be required to be registered with the Commission as a commodity pool operator, *provided:* (i) the pool operator was located outside of the US; (ii) the operator confined its activities to areas outside of the US; and (iii) none of the pools had funds or capital contributed from US sources.[7]

The Commission formally adopted this position a few years later in amending its registration rules, explaining:

> The Commission believes that, given this agency's limited resources, it is appropriate at this time to focus its customer protection activities upon domestic firms and upon firms soliciting or accepting orders from domestic users of the futures markets and that the protection of foreign customers of firms confining their activities to areas outside this country, its territories, and possessions may best be for local authorities in such areas.[8]

The Commission's foreign futures and options rules adopt this same approach, defining a "foreign futures or foreign options customer" to mean "any person located in the United States, its territories or possessions who trades in foreign futures or foreign options."[9]

Most recently, the Commission reaffirmed this policy in amending Part 3 of its rules to exempt from registration as an FCM a foreign broker[10] that "submits any commodity interest

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7 Commission Staff Letter 76-21 (August 15, 1976). This position frequently has been cited with approval in subsequent staff letters, including: Commission Interpretative Letter No. 96-79 (October 7, 1996); Commission Interpretative Letter No. 97-03 (January 15, 1997); Commission Interpretative Letter No. 98-80 (November 25, 1998); Commission Staff Letter No. 00-95 (October 3, 2000); and Commission Staff Letter No. 01-62 (June 13, 2001).

8 45 Fed.Reg. 18356 (March 20, 1980). *See, also*, 48 Fed.Reg. 35248 (August 3, 1983).

9 Commission Rule 30.1(c), 17 CFR § 30.1(c).

10 A "foreign broker" as proposed to be redefined at Commission Rule 1.3(xx) means:

> "any person located outside the United States, its territories or possessions who is engaged in soliciting or in accepting orders only from persons located outside the United States, its territories or possessions for the purchase or sale of any commodity interest transaction on or subject to the rules of any designated contract market or swap execution facility and that, in or in connection with such solicitation or acceptance of orders, accepts any money, securities or property (or extends credit in lieu thereof) to margin, guarantee, or secure any trades or contracts that result or may result therefrom."

76 Fed.Reg. 33066, 33085-33086 (June 7, 2011).

transactions executed bilaterally, on or subject to the rules of a designated contract market, or on or subject to the rules of a swap execution facility, for clearing on an omnibus basis through a futures commission merchant registered in accordance with section 4d of the Act."[11] In proposing this amendment, the Commission noted that its purpose is to "create uniformity in treatment of commodity interest transactions that do not involve a US customer, regardless of whether the transaction is made on a designated contract market or an SEF."[12]

FCMs and other Commission registrants have been conducting business consistent with this policy for more than 35 years. Their operations and, in many cases, the operations of their non-US affiliates have been based on their understanding of the Commission's registration requirements. Altering this policy by applying a different and expanded definition of a US person for this purpose would be tremendously disruptive to the market and impose a significant operational burden on registrants and their non-US affiliates.

We respectfully submit that altering such a long standing policy could not be accomplished through adoption of this Proposed Guidance as final. Rather, the Commission would need to republish the proposed definition, soliciting comment from those market participants that had no reason to anticipate that the Proposed Guidance might affect their activities, including non-US intermediaries, and setting out a reasoned analysis indicating why the Commission's prior policies and standards were being changed.[13]

The Commission would also be required to review its rules and propose amendments to those rules affected by such a change, *e.g.*, Commission Rule 30.1(c) defining foreign futures and foreign options customers.

Maintaining a different US person standard is consistent with the different regulatory purposes underlying the registration of FCMs and other "traditional" registrants, on the one hand, and swap dealers and major swap participants, on the other. Registration of FCMs and other registrants is intended primarily as a means of assuring customer protection by assuring that registrants meet certain minimum qualifications. In contrast, registration of swap dealers and major swap participants is intended to reduce systemic risk and enhance market transparency.

If the Commission nonetheless were to determine to apply the definition of US person more broadly, we reiterate our view that the Commission must first publish such a definition for comment, along with proposed amendments to all Commission rules that would be affected

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11 Amendment to Commission Rule 3.10(c)(2), promulgated by the Commission on August 15, 2012.

12 Registration of Intermediaries, 76 Fed.Reg. 12888, 12889 (March 9, 2012).

13 "A statutory interpretation . . . that results from an unexplained departure from prior [agency] policy and practice is not a reasonable one." *Goldstein v. Securities and Exchange Commission,* 451 F.3d 873 (DC Cir. 2006) citing *Northpoint Technology, Ltd. v. FCC*, 412 F.3d 145, 156 (D.C. Cir. 2005).

by such definition. In these circumstances, we would urge the Commission to propose a more narrow definition of US person than set out in the Proposed Guidance that is "sufficiently precise to allow regulated entities to determine with confidence and specificity their regulatory obligations."[14] As SIFMA explains, the breadth of the Commission's proposed definition creates significant legal uncertainty and exposes counterparties to unnecessary regulatory risk.[15]

Even with a more narrow definition, FCMs would require significant time to review their current customers and determine whether certain customers currently considered non-US should be deemed to be US persons. In order to avoid a disordered rush to identify such non-US customers and re-document such relationships, potentially leaving some customers without time to onboard with an FCM, we suggest that FCMs, non-US intermediaries and their customers would require at least 12 months to complete this process and effect any required transfers to US FCMs.

Substituted Compliance

FIA shares SIFMA's concern that the "concept of 'substituted compliance,' as proposed is unnecessarily narrow and does not accord with generally accepted notions of comity," and encourages the Commission to "adopt an approach to cross-border transactions that is consistent not only with international notions of comity and coordination, but also with its own precedent."[16] We note that the Commission's policy as described in the Federal Register release adopting rules requiring the registration of foreign boards of trade ("FBOTs"),[17] is consistent with the policy that has guided the Commission for the past 25 years in granting exemptions from registration under the Commission's Part 30 rules governing the regulation of foreign futures and foreign options transactions.[18]

The Commission's exemptive authority under Part 30 has served as a catalyst in encouraging international cooperation and coordination and has facilitated the growth of the international derivatives markets. We fear that the more narrow policy reflected in the Proposed Guidance, pursuant to which the Commission "would make comparability

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14 *Id*, at p. A-10.

15 Moreover, the definitions "may not provide a sufficient jurisdictional nexus to satisfy the Commission's 'direct and significant' mandate in section 2(i) of the [Act]." SIFMA Letter, p. ___.

16 *Id*, at p. A-46.

17 "[T]he Commission's determination of the comparability of the foreign regulatory regime to which the FBOT applying for registration is subject will not be a "line by line" examination of the foreign regulator's approach to supervision of the FBOTs it regulates. Rather, it will be a principles-based review . . . pursuant to which the Commission will look to determine if that regime supports and enforces regulatory objectives in the oversight of the FBOT and the clearing organization that are substantially equivalent to the regulatory objectives supported and enforced by the Commission in its oversight of DCMs and DCOs."

18 17 CFR Part 30.

determinations on an individual requirement basis, rather than the foreign regime as a whole,"[19] will have the contrary effect. In this regard, we note the comment letters that have been filed by: (i) Swiss Financial Market Supervisory Authority FINMA;[20] (ii) the French Ministry of Economy and Finance, the Autorité de contrôle prudentiel, and the Autorité des marches financiers;[21] (iii) the Japanese Financial Services Agency and the Bank of Japan;[22] (iv) the European Commission;[23] (v) the UK Financial services Authority;[24] and (vi) the Australian Securities and Investments Commission, the Federal Reserve Bank of Australia, the Hong Kong Monetary Authority, the Hong Kong Securities and Futures Commission, and the Monetary Authority of Singapore.[25]

We also have had an opportunity to review the thoughtful comment letter filed by the Futures and Options Association ("FOA"), dated August 13, 2012.[26] We generally agree with FOA's comments and concur in its conclusion that:

> From a global perspective, certain aspects of the Proposed Guidance could be seen as leading to a number of undesirable cross-border consequences, not just for swaps dealers, but also their customers, in terms of increased regulatory complexity, cost and legal risk, and, most importantly, the likely confusion for customers over applicable standards of investor protection.

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19 77 Fed.Reg. 41214, 41229 (July 12, 2012).

20 Letter from Patrick Raaflaub, Chief Executive Officer, and Mark Branson, Head of Banks Division, Swiss Financial Market Supervisory Authority FINMA, to David A. Stawick, Secretary to the Commission, dated July 16, 2012.

21 Letter from Pierre Moscovici, Minister, Ministry of Economy and Finance; Christian Noyer, Chairman, Autorité de contrôle prudentiel; and Jacques Delmas-Marsalet, Interim Chairman, Autorité des marches financiers, to David A. Stawick, Secretary to the Commission, dated July 27, 2012.

22 Letter from Masamichi Kono, Vice Commissioner for International Affairs Financial Services Agency; and Hideo Hayakawa Executive Director Bank of Japan, to David A. Stawick, Secretary to the Commission, dated August 13, 2012.

23 Letter from Jonathan Faull, Director General, European Commission, to David A. Stawick, Secretary to the Commission, dated August 24, 2012.

24 Letter from David Lawton, Director of Markets, Financial Services Authority, to David A. Stawick, Secretary to the Commission, dated August 24, 2012.

25 Letter from Belinda Gibson, Deputy Chairman, Australian Securities and Investments Commission, Malcolm Edey, Assistant Governor (Financial System) Reserve Bank of Australia, Arthur Yuen, Deputy Chief Executive, Hong Kong Monetary Authority, Keith Lui, Executive Director-Supervision of Markets, Hong Kong Securities and Futures Commission, and Teo Swee Lian, Deputy Managing Director (Financial Supervision), Monetary Authority of Singapore, to David A. Stawick, Secretary to the Commission, dated August 27, 2012.

26 Letter from the Futures and Options Association, to David A. Stawick, Secretary to the Commission, dated August 13, 2012.

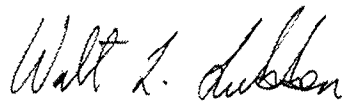
> This would be exacerbated significantly if other key jurisdictions decided to apply their rules extraterritorially to cross-border swaps.[27]

We urge the Commission to reconsider its proposed policy with regard to substituted compliance and adopt a policy that, in line with its current policies, focuses on regulatory comparability.

Conclusion

FIA appreciates the opportunity to submit this comment letter for the Commission's consideration. If the Commission has any questions regarding the matters discussed above, please contact Barbara Wierzynski, FIA's General Counsel, or me at (202) 466-5460.

Sincerely,



Walt Lukken
President and CEO

cc: Honorable Gary Gensler, Chairman
Honorable Jill E. Sommers, Commissioner
Honorable Bart Chilton, Commissioner
Honorable Scott O'Malia, Commissioner
Honorable Mark Wetjen, Commissioner

Gary Barnett, Director, Division of Swap Dealer and Intermediary Oversight
Jacqueline H. Mesa, Director, Office International Affairs
Carlene Kim, Assistant General Counsel, Office of General Counsel

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[27] *Id*, at p. 2.